BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 91-671-E - ORDER NO. 92-633

AUGUST 11, 1992

IN RE:	Lockhart Power Company - Application for an Increase in Electric Rates and Charges.	ORDER APPROVING RATES AND CHARGES

I.

INTRODUCTION

This matter comes before the Public Service Commission of South Carolina (the Commission) by way of an Application filed on February 12, 1992, by Lockhart Power Company (Lockhart or the Company) whereby the Company notified the Commission of proposed changes in its rates and charges for retail electric service provided by the Company. According to the Company's Application, the proposed rates and charges which were attached to the Application and incorporated therein as an Exhibit would have produced additional annual revenues from electric retail operations in the amount of $288,099 had they been in effect for the twelve month period ending November 30, 1991. These additional revenues represent an approximate 2.88% increase in the Company's revenues attributable to its electric retail operations for that period.

According to the Application, Lockhart has recently made and will continue to make investments in its hydroelectric units by rehabilitating them. Consequently, according to the Application, Lockhart's return on rate base for its retail operations is only 9.13% for the twelve months ended November 30, 1991. Lockhart has proposed rates in its Application which would produce a rate of return on retail rate base of 12.25% during the test year after appropriate pro forma adjustments. Further, according to Lockhart's Application, a 12.25% return on retail rate base was a fair and reasonable rate of return for Lockhart.[1] Lockhart intends to collect from its retail customers during the first month the proposed rates are in effect the unbilled revenue resulting from Lockhart's purchased power adjustment clause, the mechanics of which create a one-month delay in its collection. Lockhart has also requested approval of its latest depreciation study, with said depreciation rates requested to be placed into effect on December 1, 1991.

The Commission's Executive Director instructed the Company to cause to be published a prepared Notice of Filing and Hearing once a week for three consecutive weeks in newspapers in general circulation in the affected area. The Notice of Filing and Hearing indicated the nature of the Company's Application and advised all interested parties desiring to participate in the proceeding of the manner and time in which to file the appropriate pleadings. The Company was likewise required to notify directly all customers

1. On May 13, 1992, Lockhart, the Consumer Advocate, and the Commission Staff entered into a Stipulation, by which the parties agreed that, for purposes of this case, the return on equity would be 11.75%, based on a capital structure of 100% common equity. Hearing Exhibit 1.

affected by the proposed rates and charges. Thereafter, the Company furnished affidavits demonstrating that the Notice of Filing and Hearing had been duly published in accordance with the instructions of the Executive Director. In addition, the Company certified that a copy of the Notice of Filing and Hearing had been mailed to each customer affected by the rates and charges proposed in the Company's Application.

A Petition to Intervene was filed on behalf of the South Carolina Department of Consumer Affairs (the Consumer Advocate).

Thereafter, pursuant to Notice duly provided in accordance with the applicable provisions of law and with the Commission's regulations, a public hearing relative to the matters asserted in the Company's Application was commenced on June 17, 1992. M. John Bowen, Jr., Esquire, represented the Company; Elliott F. Elam, Jr., Esquire, represented the Consumer Advocate; and F. David Butler, Esquire, represented the Commission Staff. The following witnesses were presented at the hearing: for Lockhart, Leslie S. Anderson, General Manager and Assistant Treasurer; Charles R. Parmelee, Principal, Parmelee & Associates; and Hugh A. Gower, Partner, Arthur Andersen and Company; for the Commission Staff, Sharon G. Scott, Raymond C. Sharpe, III and Randy H. Erskine.

II.

FINDINGS OF FACT

Based upon the substantial evidence on the whole record of this proceeding, the Commission has made the following findings of fact. The complete discussion of the supporting evidence and the associated conclusions are contained in subsequent sections of this Order.

1. Lockhart Power Company is a public utility operating in South Carolina where it is engaged in the generation, transmission, distribution and sale of electricity to the public for compensation. Lockhart's retail electric operations in South Carolina are subject to the jurisdiction of the Commission pursuant to S.C. Code Ann., §58-27-10, etc. (1976), as amended.

2. The test period established for the purposes of this proceeding is the twelve-month period ending November 30, 1991, adjusted for certain known and measurable changes.

3. By its Application herein, Lockhart is seeking approval of rates and charges for retail electric operations which would produce additional annual revenues of $288,099.

4. By its Application, Lockhart's presently approved rates and charges produced operating revenues of $10,018,433 as adjusted and allocated to retail electric operations.

5. The reasonable test year operating expenses for Lockhart's retail electric operations after pro forma adjustments and prior to the effect of the proposed increase approved herein are $9,243,971.

6. The appropriate operating expenses for Lockhart's retail electric operations after approval of the rates and charges herein are $9,321,858.

7. Lockhart's test year total retail electric operating income for return after accounting and pro forma adjustments and

prior to the effect of the proposed increase is $784,608. Under the rates and charges approved herein, Lockhart's total income for return for its retail electric operations is $915,576.

8. Lockhart's original cost rate base allocated to retail electric operations for the test year after approved accounting and pro forma adjustments is $7,792,141.

9. The capital structure utilized by the Commission in this proceeding for the determination of the fair overall rate of return is the existing capital structure of Lockhart which is comprised of 100% equity with no debt.

10. The fair rate of return on common equity which Lockhart should be allowed a reasonable opportunity to earn is 11.75% which is adopted by the Commission for this proceeding, along with a range of reasonableness of 11.50%-12.00%.

11. Based upon the specific findings and conclusions herein, Lockhart's annual revenue requirement for its retail electric operations is $10,225,595 which will allow Lockhart a reasonable opportunity to earn the fair rate of return on its jurisdictional rate base which the Commission has found just and reasonable. The rates approved herein are intended to produce additional revenues for retail electric operations of $207,162.

12. The cost of service methodology, rate design, and rate schedules as further described herein are appropriate and should be adopted for the purpose of this proceeding.

13. That Lockhart's depreciation study is reasonable and should be approved. Hearing Exhibit 6.

III.

EVIDENCE AND CONCLUSIONS

Evidence and Conclusions for Finding No. 1 (legal and operational description of Lockhart).

The evidence supporting the finding concerning the legal and operational descriptions of Lockhart and its jurisdictional business is contained in the verified application. This finding is fundamentally informational, procedural and jurisdictional in nature and the matters which it addresses are essentially uncontested.

Evidence and Conclusions for Finding No. 2 (test period).

The evidence for this finding is contained in Lockhart's verified application and in the testimony and exhibits of Lockhart's witnesses. The Application and its exhibits were based upon a test year consisting of the twelve months ending November 30, 1991. The Commission Staff and the parties of record likewise offered their evidence generally within the context of that same period.

A fundamental principle of the ratemaking process is the establishment of a test year period. The reliance upon the test year concept, however, is not designed to preclude the recognition and use of other historical data which may precede or post date the selected twelve month period.

Integral to the use of the test year, representing normal operating conditions to be anticipated in the future, is the necessity to make normalizing adjustments to the historic test year figures. Only those adjustments which have reasonable and definite characteristics and which tend to influence reflected operating experience are made to give proper consideration to revenues, expenses and investments. Parker vs. South Carolina Public Service Commission, et.al., 280 S.C. 310, 313 S.E. 2d 290 (1984). Adjustments may be allowed for items occurring in the historic test year, but which will not recur in the future, or to give effect to items of an extraordinary nature by either normalizing or annualizing such items to reflect more accurately their annual impact, or to give effect to any other item which should have been included or excluded during the historic test year. The Commission concludes that the twelve months ending November 30, 1991, is the reasonable period for which to make our ratemaking determinations herein. The relevant evidence of record and the parties' discovery responses have been submitted in accordance with this conclusion and our traditional practice and precedent.

Evidence and Conclusions for Finding No. 3 (additional annual revenues requested).

The evidence supporting the finding concerning the additional annual revenues of $288,099 produced by Lockhart's proposed rates and charges is found in the Commission's Staff Report.

Evidence and Conclusions for Finding No. 4 (adjustment to operating revenues).

The evidence for the finding concerning the adjusted level of per book operating revenue of $10,018,433 is found in the testimony and exhibits of the Commission Staff's witnesses.

Lockhart proposed to decrease the level of the purchased power in the base rates from $.036938 per kwh to $0.036928, which reflects the actual costs during the test year. In order to avoid a one time mismatch of expenses and revenues due to the one month delay in billing of this cost, Lockhart requests approval to use the presently approved Purchase Power Base ($.036938) to calculate the Purchased Power Adjustment (PPA) for the initial month that the new base rates are in effect. No party took exception to this request and it is approved by the Commission.

Further, both the Company and the Staff proposed a $151,978 adjustment to operating revenues to adjust for additional revenues that would have been collected if the present rates were in effect the entire year. No party opposed this adjustment, and it is therefore adopted.

Evidence and Conclusions for Finding No. 5 (accounting and pro forma adjustments to operating expenses).

Certain adjustments affecting operating expenses were included in the exhibits and testimony offered by witnesses for Lockhart and the Commission's Staff. This Order will discuss in detail only those accounting and pro forma adjustments which represent the differences between the Company's and the Staff's treatment of the respective items only as they pertain to Lockhart's retail electric operations. The operating expenses after the pro forma adjustments and prior to the effect of the proposed increase approved herein are $9,243,971.

MISCELLANEOUS ADJUSTMENTS

Both Staff and the Company propose an adjustment of $14,784 to operation and maintenance expenses, and an adjustment of $7,039 to administrative and general expenses to adjust for a wage increase of 4.5% effective after October 7, 1991. No party opposes this adjustment and it is therefore granted. Both Staff and the Company propose an adjustment of $5,850 to administrative and general expenses to amortize the cost of the Company's depreciation study over a three (3) year period. Again, no party opposes this adjustment and it is therefore granted.

OTHER ACCOUNTING AND PRO FORMA ADJUSTMENTS

A. Rate Case Expenses

The Staff proposes an adjustment of ($5,199) and the Company proposes an adjustment of ($2,929) to administrative and general expenses to amortize rate case expenses over a three (3) year period. After examination of the record, the Commission believes that Staff's adjustment should be adopted, and it is therefore adopted.

B. Depreciation Expenses

In order to adjust depreciation expenses for lower depreciation rates as per the 1991 Depreciation Study, and to annualize depreciation expenses, the Staff recommends an adjustment of ($11,204) to depreciation expenses and to accumulated depreciation. The Company recommends an adjustment of ($7,937) to depreciation expenses and ($7,531) to accumulated depreciation. The Commission believes that Staff's adjustment should be adopted, since, in the Commission's opinion, the Staff position more accurately reflects an appropriate adjustment of depreciation expenses.

C. Non-Allowable Expenses

The Staff proposes an adjustment of ($44) to operation and maintenance expenses and ($2,483) to administrative and general expenses to remove expenses which are considered non-allowable for ratemaking purposes. These consist of such items as Chamber of Commerce membership dues, service awards, memorial awards, charitable contributions and miscellaneous goodwill expenses. Historically, the Commission has considered these items to be below-the-line expenses for ratemaking purposes. Therefore, the Commission accepts Staff's adjustment.

D. Property, Payroll, & Revenue Taxes

Both the Company and the Staff propose an adjustment to adjust for property, payroll, and revenue taxes. The Company proposes an adjustment of $33,312 and the Staff an adjustment of $33,439. The Commission believes that the Staff's adjustment is correct and should be adopted.

E. Interest on Customer Deposits

The Company and Staff have proposed an adjustment of $4,051 to interest on customer deposits to reflect annualized interest which provides a match with customer deposits at the end of the test year. The Commission finds that this adjustment is in accordance with the Commission's standard ratemaking procedures, and accepts the proposed adjustment.

F. Income Taxes

The Company and Staff proposed to adjust income taxes for the effects of the accounting and pro forma adjustments. Staff recommends an adjustment of $42,036 and the Company, an adjustment of $37,538. The Commission believes the Staff's figure more properly reflects the effects of these accounting and pro forma adjustments, and therefore adopts Staff's adjustment.

G. Accumulated Deferred Income Taxes

The Staff and the Company propose to adjust accumulated deferred income taxes to reflect lower depreciation rates. The Staff recommends an adjustment of $13,364 and the Company an adjustment of $12,223. The Commission accepts Staff's adjustment.

H. Increases in Officers' Salaries

The Consumer Advocate recommends an adjustment of ($2,579) to adjust for the effect of increases in officers' salaries during the test year. This procedure has been used historically by the Commission, and therefore the Commission adopts the Consumer Advocate's proposed adjustment.

I. Expenses for Cost of Service Study

The Consumer Advocate also recommends removal of the expenses for the cost of service study associated with resale customers from South Carolina retail operation and maintenance expenses. The Consumer Advocate recommends an adjustment of ($4,371). It should be noted that the Company has acknowledged that this amount should be charged to the resale customers. The Commission hereby approves the adjustment.

J. Purchased Power Expense

The Company has invested approximately $4 million dollars in its hydro electric plant and equipment from November 1988 through November 1991. This rehabilitation will increase the Company's hydro electric generation and at the same time reduce overall operation and maintenance expenses. The Company believes that this rehabilitation will reduce the purchased power expense by $346,000. The Consumer Advocate recommends the reduction of the Company's purchased power expense by the amount of $346,017. The Commission Staff and the Company have taken a position that the purchased power clause will adjust for this reduction. The Commission believes that one of the purposes of the purchased power clause is to adjust for increases or reductions in purchased power expense. The Commission therefore adopts the Commission Staff and Company position and grants no adjustment in this area.

The Commission has considered all other adjustments to, or treatment of revenues, expenses, or rate base items proposed by the Staff in its presentation not specifically addressed herein, and has found the adjustments fair and reasonable, and adopted the same for purposes of this proceeding, pursuant to Staff's methodology. All other adjustments proposed by any party inconsistent therewith have been reviewed and found to be unreasonable and inappropriate for ratemaking purposes and are hereby denied. General taxes, state income taxes, and federal income taxes have been adjusted to reflect all adjustments approved by the Commission.

Evidence and Conclusions for Finding Nos. 6 & 7 (operating expenses and income for return after increase).

The derivation of Lockhart's operating expenses of $9,321,858 and income for return of $915,576 after the approval of rates and charges herein is based upon our findings in Nos. 5, 10, and 11.

Evidence and Conclusions for Finding No. 8 (original cost rate base).

Pursuant to S.C. Code Ann., §58-27-180 (1976), the Commission has the authority after hearing to ascertain and fix value of the property of an electrical utility. In the context of a ratemaking proceeding, such authority is exercised in the determination of the electrical utility's rate base.

For ratemaking purposes, the rate base is the total net value of the electrical utility's tangible and intangible capital or property value on which the utility is entitled to earn a fair and reasonable rate of return. The rate base, as allocated or assigned directly to Lockhart's retail electric operations, is composed of the value of Lockhart's property used and useful in providing retail electric service to the public, plus construction work in progress, materials and supplies, and allowance for cash working capital. The rate base computation incorporates reductions for the reserve for depreciation and amortization, accumulated deferred income tax, and customer deposits. In accordance with its standard practice, the Accounting Department of the Commission Staff conducted an audit and examination of Lockhart's books, and verified all account balances from Lockhart's general ledger, including rate base items, with plant additions and retirements. On the basis of this audit, the pertinent hearing exhibits, and the testimony contained in the record of the hearing, the Commission can determine and find proper balances for the components of Lockhart's rate base, as well as the propriety of related accounting adjustments.

For ratemaking purposes, this Commission has traditionally determined the appropriate rate base of the affected utility at the end of the test period. This Commission's provisions for the determination of a utility's rate base on a "year end" basis likewise serves to enhance the timeliness of the effect of such action and preserves the reliance on historical and verifiable accounts without resort to speculative or projected figures. Consequently, the Commission finds it most reasonable to retain its consistent regulatory practice herein and evaluate the issues of this proceeding founded on a rate base for Lockhart's retail electric operations as of November 30, 1991.

When the rate base has been established, Lockhart's total operating income for return is applied to the rate base to determine what adjustments, if any, to the present rate structure are necessary to generate earnings sufficient to produce a fair rate of return. The rate base should reflect the actual investment made by investors in Lockhart's property and the value upon which stockholders will receive a return on their investment.

Therefore, the proper rate base to be used for ratemaking purposes is included in the following table:

ORIGINAL COST RATE BASE
RETAIL ELECTRIC
NOVEMBER 30, 1991

Gross Plant in Service	$15,280,945
Reserve for Depreciation	(6,828,373)
Net Plant	$ 8,452,572
Accum. Def. Income Taxes	(785,145)
Construction Work in Progress	46,336
Materials and Supplies Inventory	135,373
Cash Working Capital Allowance	-0-
Customer Deposits	(56,995)
Total Original Cost Rate Base	$ 7,792,141

Evidence and Conclusions for Finding of Fact No. 9 (Capital Structure).

Lockhart Power Company's Application and Testimony proposed the use of the Company's existing capital structure which is comprised of 100% equity with no debt as of November 30, 1991. On May 13, 1992, all parties entered into a Stipulation, which recognized the appropriateness of the continued regulation of Lockhart based upon a rate of return methodology, and actual capital structure (100% equity) at this time, although the Consumer Advocate expressed concerns about the use of such a capital structure for ratemaking purposes. The Commission, however, adopts the terms of the Stipulation, and holds that it shall continue to regulate Lockhart based on actual capital structure at this time. The Commission will continue, however, to monitor the issue of the appropriate capital structure for Lockhart Power Company within future rate cases. Circumstances existing in the future could warrant the use of a capital structure for ratemaking purposes different from the one currently employed by the Company.

Evidence and Conclusions for Findings Nos. 10 & 11 (cost of equity).

One of the principal issues in any ratemaking determination involves the proper earnings to be allowed on the common equity investment of the regulated utility. In this proceeding, all parties stipulated that an appropriate rate of return on common equity for Lockhart was 11.75%, with future earnings of the Company to be examined within a range of reasonableness between 11.50%-12.00% until the cost of capital is re-examined and modified by future order of the Commission in a future proceeding.[2] Because of the reasoning stated below, the Commission adopts the terms of the parties' Stipulation in this regard.

This Commission has frequently stated that it adheres to no particular theory or methodology for the determination of a fair rate of return on common equity. Rather, the Commission has perceived its functions as that of engaging in a careful and reasoned analysis of the theories for application in a practical context.

The United States Supreme Court's landmark decision in Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679 (1923), delineated general guidelines for determining the fair rate of return in utility regulation. In the Bluefield decision, the Court stated:

> What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment,

2. See Stipulation of the parties of May 13, 1992 at 2. Hearing Exhibit 1.

> having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional rights to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.

262 U.S. at 692-693.

During the subsequent year, the Supreme Court refined its appraisal of regulatory precepts. In its frequently cited Hope decision, supra, the Court restated its view:

> We held in Federal Power Commission v. Natural Gas Pipeline Co., ...That the Commission was not bound to the use of any single formula or combination or formulae in determining rates. Its ratemaking function, moreover involves the making of 'pragmatic adjustments.' ...Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling...
>
> The ratemaking process under the Act, i.e., the fixing of 'just and reasonable' rates, involves a balancing of the investor and the consumer interests. Thus we stated in the Natural Gas Pipeline Co. case that regulation does not insure that the business shall produce net revenues. But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to

> the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

320 U.S. at 602-603. (Citations omitted)

The vitality of these decisions has not been eroded, as indicated by the language of the more recent decision of the Supreme Court in IN RE: Permian Basin Area Rate Cases, 390 U.S. 747 (1968). This Commission has consistently operated within the guidelines set forth in the Hope decision. See Southern Bell Telephone and Telegraph Co. v. S.C. Public Serv. Com'n., 270 S.C. 590, 244 S.E.2d 278 (1978).

In the final analysis, the Commission must use its judgment in evaluating the evidence in regard to the cost of common equity, a matter which is within the expertise of the Commission.

This Commission has decided the issue of the need for an adjustment to the cost of equity on a case by case basis. It has allowed an adjustment where necessary and denied an adjustment when it was determined to be unnecessary. For example, in Order No. 88-864, issued on August 29, 1988, for Carolina Power & Light Company, the Commission allowed no adjustment for issuance expenses because the Company had no plans to issue common equity in the near future. (Order at 56.) In Order No. 88-1211, issued on December 1, 1988, for United Cities Gas Company, the Commission found an adjustment should be made, because it believed that the Company would issue common equity in the near term. (Order at 22.) In

Docket No. 88-681-E, Order No. 89-588, dated July 3, 1989, the Commission made no adjustment for South Carolina Electric and Gas Company to the cost of equity for issuance expenses. No adjustment was made in Order No. 89-1074 for the gas operations of South Carolina Electric and Gas Company because the Company provided no evidence that it intended to issue common equity in the near term. The Commission feels that no such adjustment should be allowed for Lockhart Power Company since the Company does not issue equity to the public and has no plans to make such an issue.

The Commission recognizes the legal principle that the Company be allowed an opportunity to earn a fair return sufficient to enable it to continue to meet its service obligations and maintain its financial integrity. In light of all the evidence presented in this case and made part of the record, the Commission is of the opinion, and so finds, that the fair and proper return on common equity is 11.75%. The Commission considers that rate to represent the reasonable expectation for the equity owner. This rate of return found fair and reasonable is sufficient to protect the financial integrity of Lockhart, to preserve the property of the investor, and to permit Lockhart to continue to provide reliable services to present and future customers at reasonable rates. The Commission also believes, however, and holds, that, as per the Stipulation of the parties, the future earnings of Lockhart in this Docket should be examined within a range of reasonableness between 11.50%-12.00% until the cost of capital is re-examined and modified by future Order of this Commission in a future proceeding.

An important function of ratemaking is the determination of the overall rate of return which the utility should be granted. This Commission has utilized the following definitions of "rate of return" in previous decisions, and continues to do so in this proceeding:

> For regulatory purposes, the rate of return is the amount of money earned by a regulated company, over and above operating costs, expressed as a percentage of the rate base. In other words, the rate of return includes interest on long-term debt, dividends on preferred stock, the earnings on common stock and surplus. As Garfield and Lovejoy have put it 'the return is that money earned from operations which is available for distribution among the various classes of contributors of money capital. In the case of common stockholders, part of their share may be retained as surplus.'

Phillips, The Economics of Regulation, pp. 260-261 (1969).

The amount of revenue permitted to be earned by the Company through its rate structure depends upon the rate base and the allowed rate of return on the rate base. As previously discussed, the primary issue between the regulated utility and regulatory body most frequently involves the determination of a reasonable return on common equity. Although the determination of the return on common equity provides the necessary component from which the rate of return on rate base can be derived, the overall rate of return, as set by this Commission, must also be fair and reasonable. The Commission feels that a return on rate base of 11.75% is indeed fair and reasonable. Patently, however, the Company must insure that its operating and maintenance expenses remain at the lowest level consistent with reliable service and exercise appropriate managerial efficiency in all phases of its operations. The Commission has consistently manifested its abiding concern for the establishment and continuation of efficiency programs on the part of its jurisdictional entities. See, e.g., Order No. 84-142, issued in Docket No. 83-307-E. By its Directive of August 27, 1974, to which we still adhere, the Commission urged the derivation of cost control studies, the adoption of cost reduction programs, and the elimination and reduction of costs "in all possible ways."

The Commission has found that Lockhart's capitalization ratio as of November 30, 1991, is appropriate and should be used in the instant proceeding. For the purposes of this proceeding, the Commission finds the proper cost rate for the Company's common equity capital to be 11.75%.

Using these findings, the overall rate of return on rate base for Lockhart Power Company is 11.75% and may be derived as computed in the following table:

COMPONENT OF CAPITAL STRUCTURE	RATIO (%)	COST RATE (%)	OVERALL RATE (%)
Common Equity	100.00	11.75	11.75
TOTAL	100.00		11.75

Evidence and Conclusions for Finding of Fact No. 12 (Rate Design).

The Commission is responsible for the determination of the specific rates and the development of the rate structure that will yield the required revenues. It is generally accepted that proper utility regulation requires the exercise of control over the rate structure to ensure that equitable treatment is afforded each class of customer.

The Commission's statutory responsibility to fix just and reasonable rates has been exercised by the recognition of the objective to provide a utility a fair opportunity to earn a reasonable return which meets the established revenue requirement and equitably apportions the revenue responsibility among the classes of service. In our discharge of that responsibility, we have traditionally adhered to the following criteria:

(a) The revenue requirement or financial need objective, which takes the form of a fair return standard with respect to private utility companies;

(b) The fair cost apportionment objective, which invokes the principle that the burden of meeting total revenue requirements must be distributed fairly among the beneficiaries of the service; and

(c) The optimum use or customer rationing objective under which the rates are designed to discourage the wasteful use of public utility services while promoting all use that is economically justified in view of the relationships between cost incurred and benefits received. Bonbright, Principles of Public Utility Rates (1961, page 292). These criteria have been consistently observed by this Commission and again are utilized in this matter.

The cost of supplying electricity to different customers is a function of many factors and variables. The allocation of these costs among the different classes of customers represents a complex task, since many of the total costs of producing energy are common to all customers. The procedure generally used by this Commission in analyzing utility costs in the context of the review of rate design provides for the assignment of the distribution of total costs among three major categories based on (1) costs that are a function of the total number of customers, (2) costs that are a function of the volumes of the service supplied or energy costs, and (3) costs that are a function of the service capacity of plant and equipment in terms of capability of carrying hourly or daily peak loads or demand costs.

In concluding that rates should be based on cost of service principles, the Commission reflects the economic theory that regulation is intended to act as a surrogate for competition by insuring that each rate that is charged for electricity is fair and reasonable, that is, that utility rates are maintained at the level of costs, including a fair return on capital. By incorporating cost of service principles, the Commission provides for rates and charges which are designed to promote equity, engineering efficiency (cost minimization), conservation and stability.

The foundation for an equitable and efficient cost-based rate structure is a cost of service study which accounts for the variables and factors from which are derived the cost of supplying electricity to different classes of customers. The cost of service study not only identifies the total cost of service and thereby measures that profitability of the utility, but also identifies the cost by function and class of service and so measures the compensability of service to any one class. Furthermore, the cost of service study is used to assess the propriety of any one particular rate structure in the design of rates. In a sense, a cost of service study functions as a regulatory guide by which the ratemaker can determine the existing rate of return to each class and the manner and extent to which it should be adjusted to achieve cost-based rates.

Lockhart sponsored a cost study in support of the resultant rates and charges. Lockhart owns and operates an electric system which provides electric energy to approximately 7,396 retail customers, including 4,535 residential customers, 721 commercial customers, 12 industrial customers and 2,128 lighting customers. Lockhart also serves one wholesale customer. Each of these classes of customers contributes a different load characteristic and resulting cost-to-serve. In order to determine that each customer class is providing adequate revenue to cover the cost-to-serve, a cost of service study was performed. This study is designed to separate the Company's revenues, expenses and rate base into proportionate shares for each rate class. To do this, the Company has chosen the "Average & Excess" method of allocation for the demand-related items. Energy-related items are allocated based on the energy used by each class during the test period, and for the customer-related items, the number of customers in a class was used to determine the weighting of the allocation factors. In all cases where revenues, expenses, or rate base items are for a specific customer class, that item is directly assigned. No party took exception to the Company's proposed method and the Commission accepts this proposal. This is the same methodology accepted for Lockhart in prior cases.

The cost of service study was the basis for all proposed rates. Although these studies revealed major differences in the rates of return paid by the different rate classes, it seemed that bringing all classes to equal rates of return would place undue burden on classes such as commercial; therefore, classes were moved toward equal rates of return rather than attempting to achieve rate equalization in a single move. All classes except Industrial received various increases to the same level of return. The Industrial class return continued to be several basis points above the other classes' proposed return, therefore, no increase was proposed for this class. The Consumer Advocate, however, recommends that the industrial rates be increased at 50% of the average increase experienced by the other classes, since in the Consumer Advocate's opinion, it is unfair for the industrial class to avoid bearing any costs associated with the rehabilitated plants. As was stated above, however, the industrial return was several basis points above the other classes' proposed returns. Staff agrees with the Company's proposal. We agree with Staff and hold that no increase should be granted for the Industrial class. The Commission Staff and the Company believe that the Company's method is a more acceptable means of moving towards rate of return equalization. The Commission accepts the recommendation of the Staff and Lockhart.

The Commission herein finds that Lockhart should be directed to file rates for approval which produce the additional revenue requirement of $207,162, which is found fair and reasonable herein, and to distribute the additional revenue responsibility consistent with the distribution contained in the rates and charges proposed herein. Based upon our determinations in this Order, the additional annual revenues produced by the rates and charges approved in this proceeding are illustrated in the following table:

CLASS OF SERVICE	APPROVED INCREASE
Residential Service Class	$151,378
Commercial Service Class	51,605
Industrial Service Class	-0-
Lighting Service Class	4,179
TOTAL JURISDICTION (Retail Electric)	$207,162

The Company proposes a Depreciation Study that included depreciation rates, lives, methods, and practices as of December 31, 1990 with respect to its production, transmission, distribution, and general plant properties. (See testimony of Company witness Gower.) No party took exception to the Study, and the Commission therefore approves it, including the implementation of these depreciation rates as of December 1, 1991.

IT IS THEREFORE ORDERED:

1. That Lockhart Power Company shall implement the rate designs and rate schedules for service as proposed by Lockhart or as modified herein to be effective for service rendered on or after the date of this Order.

2. That Lockhart Power Company file for approval within ten

(10) days from the date of this Order, rate schedules in accordance with the findings contained herein.

3. That this Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

Rudolph Mitchell

VICE Chairman

ATTEST:

Charles W. Ballentine

Executive Director

(SEAL)